

# CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

## EXECUTIVE SUMMARY

<b>Applicant:</b>	Stanford Hospital and Clinics (“SHC”) Stanford, California (Santa Clara County)	<b>Amount Requested:</b>	\$428,500,000
		<b>Date Requested:</b>	Feb. 23, 2006
<b>Project sites:</b>	Stanford, Palo Alto, Menlo Park, Redwood City and Santa Clara	<b>Requested Loan Term:</b>	40 years
		<b>Resolution Number:</b>	F-316
<b>Facility Types:</b>	Acute care and specialty care facilities		
<b>Uses of Bond Proceeds:</b> Bond proceeds will be used to construct, renovate and equip a variety of facilities at two campuses.			
<b>Type of Issue:</b>	Negotiated public offering with auction rate securities		
<b>Credit Enhancement:</b>	Ambac Assurance Corporation		
<b>Expected Credit Rating:</b>	AAA (S&P), Aaa (Moody’s), AAA (Fitch)		
<b>Underlying Rating:</b>	A (S&P), A2 (Moody’s), A+ (Fitch)		
<b>Senior Underwriter:</b>	Bear, Stearns & Co., Inc.		
<b>Bond Counsel:</b>	Orrick, Herrington and Sutcliffe LLP		
<b>Financial Overview:</b> SHC has continued to increase revenues over the last three fiscal years. SHC exhibits a strong balance sheet with adequate liquidity.			
<b>Sources of Revenue (\$000):</b>			
	<u>Amount</u>	<u>Percent</u>	
(FYE 8/31/05)			
Net Patient Service Revenue	\$1,274,774		93.4%
Other Revenue	48,810		3.6%
Premium Revenue	19,079		1.4%
Investment Income	17,549		1.3%
Net Assets Released From Restrictions	<u>4,531</u>		<u>0.3%</u>
	<u>\$1,364,743</u>		<u>100.0%</u>
<b>Estimated Sources of Funds (\$000’s):</b>			
Par Amount of CHFFA Bonds	\$428,500	<b>Estimated Uses of Funds (\$000’s):</b>	
		Construction/Renovation	\$256,860
		Equipment/IT	123,834
		Capitalized interest	28,553
		Bond Insurance	15,497
		Costs of Issuance	<u>3,756</u>
Total Sources	<u>\$428,500</u>	Total Uses	<u>\$428,500</u>
<b>Legal Review:</b> No information was disclosed to question the financial viability or legal integrity of the Applicant.			
<b>Staff Recommendation:</b> Staff recommends the Authority approve a Resolution in an amount not to exceed \$428,500,000 for Stanford Hospital and Clinics subject to a bond rating of at least an “A” category rating by a nationally recognized rating agency.			

**STAFF SUMMARY AND RECOMMENDATION**

**Stanford Hospital and Clinics (“SHC”)**

February 23, 2006  
Resolution Number: F-316

**I. PURPOSE OF FINANCING:** Bond proceeds will be used to construct, renovate and equip a variety of facilities in several locations and to purchase information technology equipment. Proceeds will also be used to ensure that the facilities meet or exceed all seismic requirements.

**Construction/Renovation ..... \$256,860,180**

*Construction ..... \$161,298,710*

SHC will construct a large medical office complex in Redwood City that will comprise four buildings and consist of 360,000 square feet. The facility will be built to accommodate short stay procedures and other clinical services with the Orthopedic Center as the core component.

*Facility renovations ..... \$95,561,470*

SHC will renovate several existing buildings including the hospital and the cancer center. At the hospital, projects will include various ongoing renovations, fire alarm system upgrades, build-out of three cardiac catheterization labs, upgrades to nuclear medicine and upgrades to meet seismic requirements.

SHC will build-out the third floor of the Cancer Center that is currently shell space. The build-out will include three interventional radiology rooms and twelve operating rooms, along with prep, recovery and sterilization space.

**Equipment/Information technology ..... 123,834,524**

Bond proceeds will be used to purchase a variety of new equipment and replacement medical equipment for various services including nuclear medicine, endoscopy, surgical pathways and transfusions. Proceeds will also be used to upgrade the information technology needs of the institution.

**Insurance ..... 15,496,460**

**Capitalized interest fund ..... 28,553,271**

**Other financing costs are as follows..... 3,755,565**

*Underwriters discount* ..... 2,163,065

*Estimated issuance costs*..... 1,592,500

**Total Uses of Funds..... \$428,500,000**

**Structure of Financing:**

- Negotiated public offering, 7- and 35-day auction rate
- Credit enhancement: Ambac Assurance Corporation
- Expected Credit Rating: AAA (S&P) & Aaa (Moody's), AAA (Fitch) based on insurance
- General obligation & gross revenue pledge
- Financial covenants acceptable to Authority in accordance with guidelines for "A" rated financings.

## II. FINANCIAL STATEMENTS AND ANALYSIS

Stanford Hospital and Clinics  
Consolidated Statements of Operations (\$000)  
(unrestricted)

	3 months ending Nov 30	Year ended August 31,		
	2005 (unaudited)	2005	2004	2003
<b>Revenue:</b>				
Net patient service revenue	\$ 331,667	\$ 1,274,774	\$ 1,093,625	\$ 918,102
Premium revenue	5,010	19,079	19,545	20,925
Investment income	6,319	17,549	9,336	4,030
Other revenue	13,718	48,810	34,880	31,792
Net assets released from restrictions	670	4,531	3,216	8,463
Total revenues, gains, and other support	<u>357,384</u>	<u>1,364,743</u>	<u>1,160,602</u>	<u>983,312</u>
<b>Expenses:</b>				
Salaries and benefits	143,992	528,640	481,936	424,250
Professional services	3,838	14,945	22,127	29,928
Supplies	49,826	192,963	166,354	138,828
Purchased services	85,443	332,546	234,688	204,726
Provision for doubtful accounts	17,068	51,108	40,019	53,543
Depreciation and amortization	9,320	39,615	33,550	27,277
Interest	4,688	19,280	16,676	8,428
Other	25,199	92,156	107,282	84,665
Expense recoveries from related parties	(12,689)	(46,245)	(43,334)	(34,340)
Total expenses	<u>326,685</u>	<u>1,225,008</u>	<u>1,059,298</u>	<u>937,305</u>
Excess of revenues, gains, and other support over expenses	30,699	139,735	101,304	46,007
Transfer to/from Stanford University	-	(14,524)	(10,273)	31,038
Change in net unrealized gain (losses) on investments	5,864	10,670	(382)	1,322
Net assets released from restrictions used for purchase of property and equipment	6	71	4,669	610
Change in minimum pension liability	-	(22,835)	11,442	(23,857)
Other	-	-	-	8,252
Change in fair value of interest rate swaps	3,172	(9,114)	(5,030)	7,345
<b>Increase in unrestricted net assets</b>	<u>39,741</u>	<u>104,003</u>	<u>101,730</u>	<u>70,717</u>
Unrestricted net assets, beginning of year	436,479	332,476	230,746	160,029
Unrestricted net assets, end of year	<u>\$ 476,220</u>	<u>\$ 436,479</u>	<u>\$ 332,476</u>	<u>\$ 230,746</u>

Stanford Hospital and Clinics and Subsidiaries  
Consolidated Statements of Financial Position (\$000's)

	3 months as of Nov. 30	As of August 31,		
	2005	2005	2004	2003
	(unaudited)			
<b>Assets</b>				
<b>Current Assets:</b>				
Cash and cash equivalents	\$ 29,194	\$ 35,474	\$ 79,478	\$ 224,394
Assets limited to use, held by trustee	1,723	2,290	10,968	17,341
Patients accounts receivable, net	197,995	180,028	141,683	114,532
Other receivables	8,169	8,643	5,080	5,504
Inventories	14,831	14,321	13,287	11,607
Prepaid expenses and other	11,231	5,278	3,292	1,623
Due from related parties	5,303	1,717	-	6,422
<b>Total Current Assets</b>	<b>268,446</b>	<b>247,751</b>	<b>253,788</b>	<b>381,423</b>
Investments	627,896	622,361	450,440	188,094
Assets limited as to use	96,595	109,157	148,433	191,555
Property and equipment, net	271,484	270,725	251,179	230,145
Interest rate swaps	996	-	2,124	7,345
Other assets	29,209	27,574	25,431	21,061
<b>Total Assets</b>	<b>\$ 1,294,626</b>	<b>\$ 1,277,568</b>	<b>\$ 1,131,395</b>	<b>\$ 1,019,623</b>
<b>Liabilities &amp; Net Assets</b>				
<b>Liabilities:</b>				
Accounts payable and accrued liabilities	\$ 79,698	\$ 80,842	\$ 64,566	\$ 66,093
Accrued salaries and related benefits	67,136	67,892	63,310	60,785
Due to related parties	26,454	41,080	29,127	17,313
Third party payor settlements	25,374	20,181	32,411	40,808
Current portion of long term debt	3,410	3,245	3,090	2,945
Self-insurance reserves, current	19,764	18,704	20,958	18,511
<b>Total current liabilities</b>	<b>221,836</b>	<b>231,944</b>	<b>213,462</b>	<b>206,455</b>
Self-insurance reserves, net of current portion	114,482	114,037	115,505	94,745
Pension liability	40,719	49,972	27,499	38,111
Long-term debt, net of current portion	423,101	426,555	429,976	433,242
<b>Total Liabilities</b>	<b>800,138</b>	<b>822,508</b>	<b>786,442</b>	<b>772,553</b>
<b>Net Assets:</b>				
Unrestricted net assets	476,220	436,479	332,476	230,746
Temporarily restricted net assets	15,677	15,990	10,911	14,758
Permanently restricted net assets	2,591	2,591	1,566	1,566
<b>Total Net Assets</b>	<b>494,488</b>	<b>455,060</b>	<b>344,953</b>	<b>247,070</b>
<b>Total Liabilities &amp; Net Assets</b>	<b>\$ 1,294,626</b>	<b>\$ 1,277,568</b>	<b>\$ 1,131,395</b>	<b>\$ 1,019,623</b>
<b>Financial Ratios:</b>				
	Proforma (a)			
	2005	2005	2004	2003
Debt Service Coverage Ratios (x)	2.66	4.38	4.66	4.81
Debt/Unrestricted Net Assets (x)	1.97	0.98	1.35	1.95
Margin (%)		10.24	8.73	4.68
Current Ratio (x)		1.07	1.19	1.85

(a) Based on adding projected new debt to the audited 2005 financial results.

## **Financial Discussion:**

### **SHC has continued to increase revenues over the last three fiscal years.**

Total revenues have increased approximately 39% over the last three years from approximately \$983 million in fiscal year 2003 to over \$1.3 billion in fiscal year 2005. This is primarily a result of increased utilization for inpatient services. Patient days have risen 14% from fiscal year 2003 to fiscal year 2005. SHC's investment income also increased substantially over the last three fiscal years with improvements in the stock market.

During the review period, total expenses have increased approximately 31.7%, a rate slower than the growth in revenues. Purchased services, however, have increased significantly due to increased services from Stanford School of Medicine and Stanford University. These services would include emergency room coverage, physicians providing medical direction to SHC, and physicians providing services to the clinical practice. It also includes outsourcing a portion of Information Technology services and a variety of other services.

With the positive trend in its operations, SHC's growth in unrestricted net assets over the last three fiscal years increased from approximately \$71 million in fiscal year 2003 to over \$104 million in fiscal year 2005, an increase of 47%.

### **SHC exhibits a strong balance sheet with adequate liquidity.**

SHC's balance sheet continues to grow with total net assets increasing from \$247 million in fiscal year 2003 to \$455 million in fiscal year 2005, an increase of 84%. Liquidity remains adequate with a current ratio as of fiscal year 2005, of 1.07x. Cash has declined over our review period as a result of cash investments into short-term securities with a duration of three months or less.

SHC will become slightly leveraged with this financing however, the proforma debt service coverage ratio of 2.66x shows SHC will be able to manage this debt comfortably.

**III. BACKGROUND:** SHC is the principal teaching affiliate of the Stanford University School of Medicine in providing primary and specialty health services to adults. It operates Stanford Hospital, offering services in the fields of cardiac care, cancer treatment, organ transplantation, neurological services and other tertiary care to adult patients. With its sister corporation Lucile Salter Packard Children's Hospital at Stanford ("LPCH"), SHC operates the clinical settings through which the School of Medicine educates medical and graduate students, trains residents and clinical fellows, supports faculty and community clinicians and conducts medical and biological sciences research.

The principal clinical facilities of SHC are the Stanford Hospital, a 613-licensed bed tertiary, quaternary and specialty hospital, and the primary, specialty and sub-specialty clinics in which the medical faculty of the Stanford University School of Medicine provide clinical services. The hospital and the majority of the clinics are located on the campus of Stanford

University adjacent to the School of Medicine in Palo Alto, California. Other clinics are located elsewhere on the campus, nearby off-campus and in neighboring communities.

**Service Area and Competition:** SHC identifies its local market as San Mateo and Santa Clara counties, which is the source of approximately 65% of its inpatient volume. SHC's service area and competition extends beyond the normal boundaries as SHC is recognized worldwide.

**Licenses and Contracts:** The California Department of Health Services licenses the Hospital as a general acute care facility. Stanford Hospital and Clinics is certified as a provider of care for beneficiaries of the Medicare and Medi-Cal programs. SHC is accredited by the Joint Commission on Accreditation of Healthcare Organizations ("JCAHO"), which conducted its last on-site survey in April, 2004.

#### IV. UTILIZATION STATISTICS:

		<b>Stanford Hospital and Clinics</b>				
		<b><u>2003</u></b>	<b><u>2004</u></b>	<b><u>2005</u></b>	<b><u>3 months ended 11-30-04</u></b>	<b><u>3 months ended 11-30-05</u></b>
Discharges						
	Acute	18,187	20,086	20,549	4,962	5,165
	Behavioral Health	882	850	798	208	221
	Rehab	<u>267</u>	<u>314</u>	<u>345</u>	<u>81</u>	<u>77</u>
	Total	19,336	21,250	21,692	5,251	5,463
Patient Days						
	Acute	97,644	106,654	110,880	26,220	28,519
	Behavioral Health	8,550	8,686	8,377	2,166	2,223
	Rehab	<u>3,760</u>	<u>4,541</u>	<u>4,610</u>	<u>1,022</u>	<u>1,091</u>
	Total	109,954	119,881	123,867	29,408	31,843
Average Daily Census						
	Acute	267.5	291.4	303.8	288	313
	Behavioral Health	23.4	23.7	23.0	24	25
	Rehab	<u>10.3</u>	<u>12.4</u>	<u>12.6</u>	<u>11</u>	<u>12</u>
	Total	301.2	327.5	339.4	323	350
Average Length of Stay						
	Acute	5.4	5.3	5.4	5.3	5.5
	Behavioral Health	9.7	10.2	10.5	10.0	10.1
	Rehab	<u>14.1</u>	<u>14.5</u>	<u>13.4</u>	<u>13.0</u>	<u>14.2</u>
	Total	5.7	5.6	5.7	5.6	5.8
Case Mix Index		1.85	1.85	1.88	1.87	1.89
Emergency room visits		38,147	39,103	40,176	9,294	9,745
Short Stay OP Procedures*		21,539	21,242	20,972	5,073	4,285
Other Outpatient Visits**		255,057	255,956	227,827	60,274	51,762
Surgeries						
	Inpatient	9,785	10,881	11,044	2,615	2,712
	Outpatient***	<u>10,138</u>	<u>10,085</u>	<u>9,939</u>	<u>2,361</u>	<u>2,575</u>
	Total	19,923	20,966	20,983	4,976	5,287

\*Same day surgery and ambulatory treatment cases.

\*\* Actual visits will be more; these amounts are billing events which may include multiple visits.

\*\*\* Psychiatry cases have been excluded.

**V. SECTION 15438.5 OF THE ACT (Savings Pass Through):** It is the intent of the Legislature in enacting this part to provide financing only to health facilities that can demonstrate the financial feasibility of their projects. It is further the intent of the Legislature that all or part of any savings experienced by a participating health institution, as a result of that tax-exempt revenue bond funding, be passed on to the consuming public through lower charges or containment of the rate of increase in hospital rates. Pursuant to the Attorney General’s advice letter dated November 17, 2005, the “savings pass through” language is a directive (legislative goal) to CHFFA.

SHC has provided a description of its savings pass through in **Exhibit A**

**VI. SECTION 15459.1 (b) OF THE ACT (Community Service Requirement):** As a condition of the issuance of revenue bonds, whether by the Authority or any local agency, each borrower shall give reasonable assurance to the Authority that the services of the health facility will be made available to all persons residing or employed in the area served by the facility. As part of this assurance, borrowers shall agree to a number of actions, including (a) to advise each person seeking services at the borrower’s facility as to the person’s potential eligibility for Medi-Cal and Medicare benefits or benefits from other governmental third-party payers, and (b) to post notices in appropriate areas within the facility regarding services being available to all in the service area. This agreement is a standard “Certification and Agreement Regarding Community Service Obligation”.

SHC has executed this certification and whether Medi-Cal and Medicare patients are accepted. A copy of the certification is provided as **Exhibit B**.

**VII. COMPLIANCE WITH SEISMIC REGULATIONS:** SB 1953 (Chapter 740, 1994) requires that all acute care hospitals in California meet specific seismic safety standards by 2008 and 2030.

SHC has provided a description of its seismic requirements. See **Exhibit C**.

**VIII. OUTSTANDING DEBT:**

<b>Date Issued:</b>	<b>Original Amount</b>	<b>Amount Outstanding As of 8/31/05*</b>	<b>Estimated Amount Outstanding after Proposed Financing</b>
<b><i>Existing Authority Debt:</i></b>			
Series 1998B	\$193,895,000	\$176,555,000	\$176,555,000
2003 Series A-D	250,000,000	250,000,000	250,000,000
<b><i>Proposed Authority Debt</i></b>			
2006 Series A-B			428,500,000
<b>Total Debt</b>		<b>\$426,555,000</b>	<b>\$855,055,000</b>

\*Excludes current portion of long-term debt.

**IX. RELIGIOUS AFFILIATION DUE DILIGENCE:** Staff has reviewed the Applicant's responses to the questions contained in the Religious Affiliation portion of the application. No information was disclosed in the questionnaire or discovered by staff to question the Applicant's compliance with the provisions of the Authority's Act relating to religious affiliation.

**X. LEGAL REVIEW:** Staff has reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. No information was disclosed to question the financial viability or legal integrity of this applicant.

**XI. STAFF RECOMMENDATION:** Staff recommends the Authority approve a Resolution in an amount not to exceed \$428,500,000 for Stanford Hospital and Clinics subject to a bond rating of at least an "A" category rating by a nationally recognized rating agency.